Supreme Court, U. S.
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No. 97-109

In the Supreme Court of the United States

OCTOBER TERM, 1996

HELEN D. GENS, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether, under the doctrine of judicial estoppel or election of remedies, the Resolution Trust Corporation (RTC), as a holder of a promissory note executed by petitioner, was precluded from recovering against petitioner because the RTC had previously sued a prior holder to rescind an agreement that made the RTC the holder of the note.

2. Whether the bankruptcy court abused its discretion in permitting the RTC's agent to amend the RTC's proof of claim on the promissory note.

3. Whether the court of appeals applied federal common law, rather than Massachusetts law, in rejecting petitioner's defense of impairment of collateral.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-21) is reported at 112 F.3d 569. The orders of the district court (Pet. App. 30) and the bankruptcy court (Pet. App. 31-32) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 5, 1997. The petition for a writ of certiorari was filed on July 17, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

STATEMENT

1. In July 1988, petitioner executed a promissory note payable to U.S. Funding Inc. of America, in the principal amount of $70,000. Petitioner signed the note in both her "individual" capacity and her representative capacity as trustee for the Old Jail Trust. The note was secured by a third mortgage on real property in Barnstable, Massachusetts. Pet. App. 2.

U.S. Funding assigned petitioner's note to Key Financial Services, which in turn, pursuant to a purchase-sale agreement, assigned the note to Home Owners Savings Bank. In October 1989, Home Owners sued Key in district court, seeking rescission of the purchase-sale agreement on the ground that it had been induced by fraud and, in the alternative, damages for breach of the purchase-sale agreement on the ground that Key had failed to fulfill its title-insurance obligations. Pet. App. 2-3.

Following a default on the note in 1990, the first mortgagee foreclosed on the Barnstable property. After the foreclosure sale, there was no surplus available for any junior lien. Home Owners subsequently became insolvent and subject to a receivership by the Resolution Trust Corporation (RTC), which continued to pursue the litigation against Key.[1] The RTC moved for summary judgment on the breach of contract claim aganist Key. In 1992, the district court entered partial summary judgment for the RTC on the ground that Key had breached the purchase-sale agreement. The court's order directed Key to

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[1] During the pendency of these proceedings, the RTC was abolished and succeeded by the Federal Deposit Insurance Corporation (FDIC). For consistency, we refer to the holder of the claim throughout as the RTC.

repurchase the note, but that order never became final because Key and the RTC were unable to agree on a purchase price. Pet. App. 3.

2. In September 1993, petitioner commenced a voluntary Chapter 11 bankruptcy proceeding, but did not schedule the note as a liability. Five months before the bar date for filing proofs of claim in petitioner's bankruptcy case, the RTC's servicing agent on the note, Knutson Mortgage Corporation, filed a proof of claim on the note. That proof of claim listed Knutson rather than the RTC as the creditor, failed to disclose that Knutson was acting as the RTC's servicing agent, and mistakenly identified the claim as secured rather than unsecured. Pet. App. 3.

After the bar date, Knutson filed amended proofs of claim correcting those deficiencies in the original proof of claim. Petitioner objected to the amended proof of claim on three grounds relevant here. First, she argued that the amendment was untimely. Second, petitioner argued that the RTC was estopped from pursuing its claim on the note against her because the RTC had contended in its lawsuit against Key that the purchase of the note should be rescinded. Third, petitioner argued that, as an accommodation maker of the note, she had been discharged from liability because a previous holder of the note, U.S. Funding, used the loan proceeds from the note to pay off the preexisting second mortgage on the Barnstable property but failed to record the mortgage discharge. Pet. App. 4. The bankruptcy court rejected petitioner's objections (*id.* at 32, 34), and the district court summarily affirmed (*id.* at 30).

3. The court of appeals affirmed. Pet. App. 1-21. The court first concluded that the RTC, as receiver of Home Owners, was not estopped from seeking to

recover on petitioner's note. *Id.* at 4-8. The court acknowledged that "[i]mplicit in Home Owners' demand for rescission of the purchase-sale agreement was its averment that Key's fraud rendered the purchase-sale agreement voidable *ab initio*, and therefore that Home Owners never became a 'holder' of the Gens Note." *Id.* at 5. The court concluded, however, that the RTC was not thereby precluded from recovering against petitioner on the note because "[j]udicial estoppel is not implicated unless the first forum *accepted* the legal or factual assertion alleged to be at odds with the position advanced in the current forum." *Id.* at 6. Because the "first forum" here did not rule that the purchase-sale agreement was void, but rather determined that Key was liable because it had breached its obligations under the agreement, the court of appeals concluded that judicial estoppel would not preclude the RTC from recovering against petitioner. *Id.* at 7-8. For the same reasons, the court concluded that the doctrine of election of remedies, which "prevent[s] double * * * recoveries for the same wrong," did not preclude recovery by the RTC. *Id.* at 6-8.

The court also concluded that the bankruptcy court had not abused its discretion in permitting Knutson to amend its proof of claim after the bar date. The court first observed that, under Federal Rule of Bankruptcy Procedure 7015, leave to amend a proof of claim should be "freely given when justice so requires." Pet. App. 11. The court also emphasized that petitioner had shown no unfair prejudice resulting from any deficiency in the original proof of claim; petitioner "neither alleged nor demonstrated that any creditor acted in detrimental reliance on any representation or omission in the original [proof

of claim]." *Id.* at 13. The court rejected petitioner's argument that amendment of the proof of claim had prejudiced other unsecured creditors because they might have received more under a reorganization plan if the RTC's claim had been disallowed. That argument, the court noted, would preclude "virtually any amendment" of a proof of claim. *Id.* at 12-13. Under settled law, "something more than mere creditor disappointment is required to preclude amendment." *Id.* at 13.

Finally, the court rejected petitioner's argument that she was discharged from liability on the note based on U.S. Funding's alleged impairment of her collateral through its failure to record the discharge of the second mortgage. The court first observed that, in most jurisdictions, a defense based on impairment of collateral may be raised only by an accommodation maker of the note, and not by the principal obligor. Pet. App. 15. The court stated that it was uncertain whether Massachusetts courts would follow the majority rule or would hold, with the minority, that the principal debtor may also raise a defense of impairment of collateral. *Id.* at 15 n.10. It then considered petitioner's argument that she was entitled to an evidentiary hearing to prove that she was only an accommodation maker despite having signed the note in her "individual capacity." *Id.* at 16-19. The court ultimately ruled that an evidentiary hearing was not required, because petitioner had failed in any event to allege sufficient facts to establish that her collateral was actually impaired. The governing statute "plainly requires evidence that the holder's dereliction actually resulted in a loss to the accommodation party. * * * [Petitioner]

alleged no facts which would demonstrate any actual diminution of her subrogation rights." *Id.* at 19-20.[2]

ARGUMENT

1. Petitioner argues (Pet. 14-17) that the RTC was precluded from pursuing recovery on the note that she had executed because the RTC had previously sought to rescind an agreement that made the RTC a holder of the note. The court of appeals correctly rejected that contention. As the court stated, judicial estoppel applies only when the assertion in the second litigation is inconsistent with an assertion that has actually been accepted in the first litigation. See *Wang Laboratories, Inc.* v. *Applied Computer Sciences, Inc.*, 958 F.2d 355, 358 (Fed. Cir. 1992); *Patriot Cinemas, Inc.* v. *General Cinema Corp.*, 834 F.2d 208, 212 (1st Cir. 1987). Merely pleading a theory of recovery does not subject a party to judicial estoppel or a bar based on election of remedies. See *Olympia Hotels Corp.* v. *Johnson Wax Dev. Corp.*, 908 F.2d 1363, 1371 (7th Cir. 1990); cf. Fed. R. Civ. P. 8(e)(2) (permitting pleading of inconsistent claims in the alternative).

Contrary to petitioner's contention, the court of appeals' decision does not conflict with *United States* v. *Oregon Lumber Co.*, 260 U.S. 290 (1922). In *Oregon Lumber*, the Court held that the doctrine of election

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[2] The court noted that petitioner had not alleged that the failure to record the discharge of the second mortgage had permitted any other creditor to obtain a superior recourse against the Barnstable property. Moreover, because the auction sale on the Barnstable property resulted in no surplus to apply to junior liens, "the record can support no finding that any junior lien [including the third mortgage created by petitioner's note] was impaired." Pet. App. 20.

of remedies barred the United States from pursuing an action at law arising out of a fraudulent conveyance of land when it had previously filed an unsuccessful suit in equity to set aside the same conveyance. In *Oregon Lumber*, unlike this case, the plaintiff attempted to pursue two separate lawsuits against the same defendant based on the same set of facts. As the Court there observed:

> The distinguishing feature of the instant case is that after the coming in of the answer, pleading the statute of limitations, and the plain warning thus conveyed of the danger of continuing the equity suit further, the [United States] insisted in pursuing it to final judgment, instead of promptly reforming the cause or dismissing the bill and seeking the alternative remedy not subject to the same defense. The doctrine of election of remedies and that of *res adjudicata* are not the same, but they have this in common, that each has for its underlying basis the maxim which forbids that one shall be twice vexed for one and the same cause.

Id. at 301. The rationale for the decision in *Oregon Lumber* has no application to this case, for Key's breach of contract and petitioner's default on her promissory note were distinct legal wrongs committed by different parties.

2. Petitioner argues (Pet. 18-23) that the court of appeals' decision to permit amendment of the RTC's proof of claim after the bar date conflicts with *United States ex rel. Texas Portland Cement Co.* v. *McCord*, 233 U.S. 157 (1914). That contention is incorrect. In *McCord*, the plaintiff filed suit on a bond under the predecessor to the Miller Act before the

expiration of a six-month waiting period, following completion and settlement of the contract between the contractor and the United States, during which time only the United States could bring suit. The plaintiff later sought to amend its complaint after the expiration of the one-year limitation period. The Court held that the statutorily prescribed six-month waiting period was a condition precedent to the cause of action, and that the original complaint did not state a cause of action because it was filed prematurely. The Court held further that the amended complaint did not relate back to the original complaint, because the cause of action was nonexistent when the original complaint was filed. *Id.* at 163-164. Here, by contrast, the RTC's cause of action on petitioner's note existed when the original proof of claim was filed. Although the proof of claim filed by Knutson was technically flawed in that it did not identify the RTC as the real party in interest, the existence of the RTC's underlying claim was not affected by the failure to designate Knutson specifically as the RTC's servicing agent.[3]

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[3] Petitioner's reliance (Pet. 20-21) on *In re Ellington*, 151 B.R. 90 (Bankr. W.D. Tex. 1993), is also unavailing. In that case, an attorney filed a proof of claim naming First Republic-Bank of El Paso as a creditor, even though the FDIC had sold all of First Republic's assets to another bank and First Republic itself had ceased to exist. When the bank that purchased First Republic's assets, NCNB Texas National Bank, attempted to amend the proof of claim after the bar date to name itself as a creditor, the bankruptcy court refused to allow the amendment. The court reasoned that NCNB had filed no proof of claim before the bar date, and it therefore had no claim to amend. *Id.* at 94-95. The better view, however, is that amendment of a proof of claim should be freely allowed to make clear the identity of a creditor that has been assigned the

Petitioner is mistaken in contending (Pet. 22) that the court of appeals' decision conflicts with *Highlands Insurance Co.* v. *Alliance Operating Corp.*, 60 F.3d 1174 (5th Cir. 1995). In *Highlands*, the court of appeals upheld the bankruptcy court's decision to disallow a creditor's amendment of its proof of claim after the bar date to change the claim from a general unsecured claim to a priority claim. The court observed that an amendment to create a new priority claim would drastically affect the debtor's plan of reorganization, which had already been confirmed by the bankruptcy court. *Id.* at 1175. In this case, however, the courts below concluded that the change in designation of the RTC's claim from a *secured* claim to an *unsecured* claim did not unfairly prejudice either petitioner or any of the unsecured creditors. See Pet. App. 13 (noting that the RTC's amendments took place "long before the formulation of a chapter 11 plan").

Both the decision below and *Highlands* are consistent, moreover, with this Court's admonition that bankruptcy courts exercise equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will

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claim. See *In re Unioil, Inc.*, 962 F.2d 988, 992 (10th Cir. 1992). Even if the decision in *Ellington* were correct, it is distinguishable from this case because there was nothing improper about Knutson's filing the proof of claim for the RTC, or even naming itself as a creditor. Knutson was the RTC's servicing agent, and its mistake was merely in failing additionally to identify the RTC as the real party in interest. In any event, decisions on such amendments are committed to the sound discretion of the bankruptcy court, see *In re Hemingway Transport, Inc.*, 954 F.2d 1, 10 (1st Cir. 1992), and the court did not abuse its discretion in this case.

not prevent substantial justice from being done." *Pepper* v. *Litton*, 308 U.S. 295, 305 (1939). In addition, Bankruptcy Rule 7015, governing amendments of pleadings in bankruptcy courts, expressly incorporates by reference Federal Rule of Civil Procedure 15, which liberally allows the amendment of pleadings. See *In re Stavriotis*, 977 F.2d 1202, 1204 (7th Cir. 1992).

3. Finally, petitioner argues (Pet. 24) that the court of appeals disregarded Massachusetts law and improperly invoked federal common law to reject her impairment of collateral defense. That contention is without merit. The court of appeals expressly relied on Massachusetts law when it concluded that, even on the assumption that petitioner was only an accommodation maker and was therefore entitled to raise a defense of impairment of collateral, she could not do so because she had not made any allegations of loss sufficient to establish the impairment. See Pet. App. 19-20 (citing Mass. Ann. Laws ch. 106, § 3-606 (Law. Co-op. 1984)). For that reason, the court of appeals concluded that it need not reach the other issues raised by petitioner's impairment of collateral defense, including the question whether the defense would be available under the controlling law to one who was a principal debtor on the note and not an accommodation maker. *Id.* at 18, 20. The question whether Massachusetts law permitted petitioner to raise a defense of impairment of collateral as a principal obligor under the note (see *id.* at 15 & n.10) had no effect on the court's ultimate decision in the case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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